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Socially Responsible Investing With ETFs

Funds associated with activism are increasingly taking a passive approach.

Socially responsible investing (SRI) typically involves selecting stocks based on factors such as a company's human-rights record and environmental impact in addition to financial considerations.

INDEXING & ETFS

Some of the latest offerings in this category are index-tracking exchange-traded funds, including Claymore/KLD Sudan Free Large-Cap Core ETF (KSF), launched late last month, and iShares KLD 400 Social Index ETF (DSI), launched in November. An ETF resembles a mutual fund but trades on an exchange like a stock.

For SRI investors, the new ETFs can mean broad diversification, up-to-date information on fund holdings, and lower expenses in a fund category often criticized for its high fees. But investors considering these funds still need to keep a close eye on costs, as index-tracking socially responsible funds are often much more expensive than conventional index funds.

And some in the industry argue that active stock selection can boost returns for socially responsible funds and give managers more leeway to push for change at portfolio companies.

Like many passively managed funds, socially responsible index-tracking funds generally offer lower fees than their actively managed rivals. The average socially responsible index fund charges annual expenses of 0.81% of fund assets, according to investment-research firm Morningstar, compared with 1.21% for the average socially responsible actively managed fund.

But conventional index funds are often far cheaper. Vanguard Large-Cap ETF charges just 0.07%, for instance, while the new Claymore Sudan Free ETF charges 0.5%.

Since ETFs generally reveal their holdings every day, the recent index-tracking SRI offerings also allow investors to see exactly what's in the portfolio, which may be a valuable benefit to investors keen to avoid, say, alcohol and gambling stocks. Traditional mutual funds are required to disclose portfolio holdings only four times a year.

Still, some SRI fans see advantages to active management. Indeed, one of the biggest names in SRI funds dropped the indexing approach late last year. The Domini Social Equity Fund stopped tracking the Domini 400 Social Index and adopted an active stock-picking strategy.

Though the change caused the fund to raise its fees to 1.15%, from 0.95%, active management gives the fund flexibility to adjust its weightings in particular holdings, and "we've had much better performance," since making the switch, says Amy Domini, CEO of Domini Social Investments.

Over the long haul, however, "there's pretty strong evidence that SRI indexes perform very much like the broader market," says Thomas Kuh, managing director of KLD Indexes, which offers a number of socially responsible indexes.

But some in the industry also believe active management gives SRI funds greater leverage in pushing portfolio companies' management to make social or environmental policy changes. Active SRI managers often have larger stakes in individual companies and thus more leverage to push for change, says Sophia Collier, manager of the actively managed, socially responsible Citizens Value Fund. "From an SRI perspective, it's more appropriate to have an active strategy," she says.

By Eleanor Laise